



Euro Area Stresses and Policies

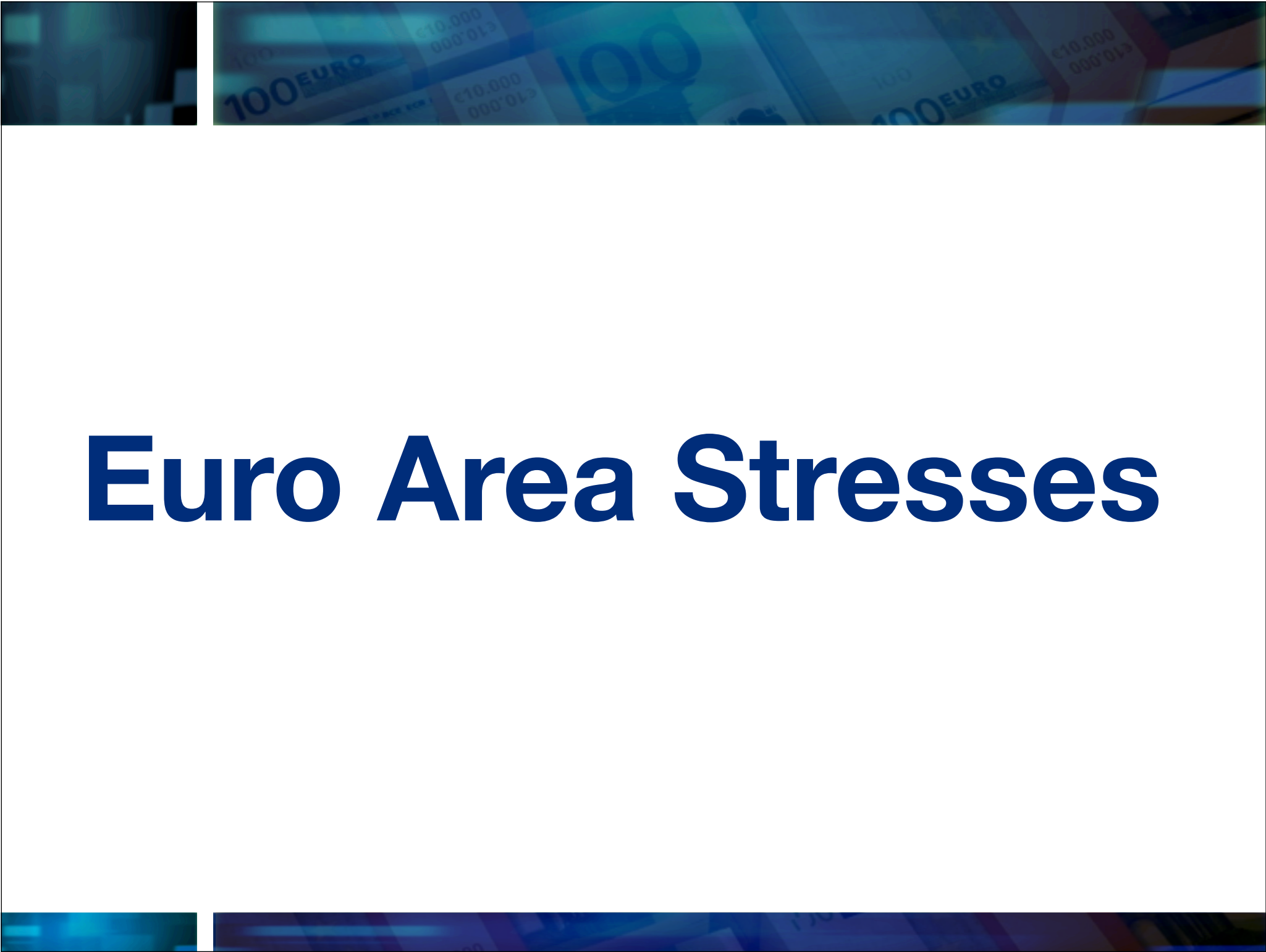
Dublin Economics Workshop

October 13

Peter Breuer

Outline

- **Euro Area Stresses**
- **Euro Area Growth**
- **Euro Area Policies**
 - ▶ **Architecture**
 - ▶ **Short-run Demand**
 - ▶ **Structural**



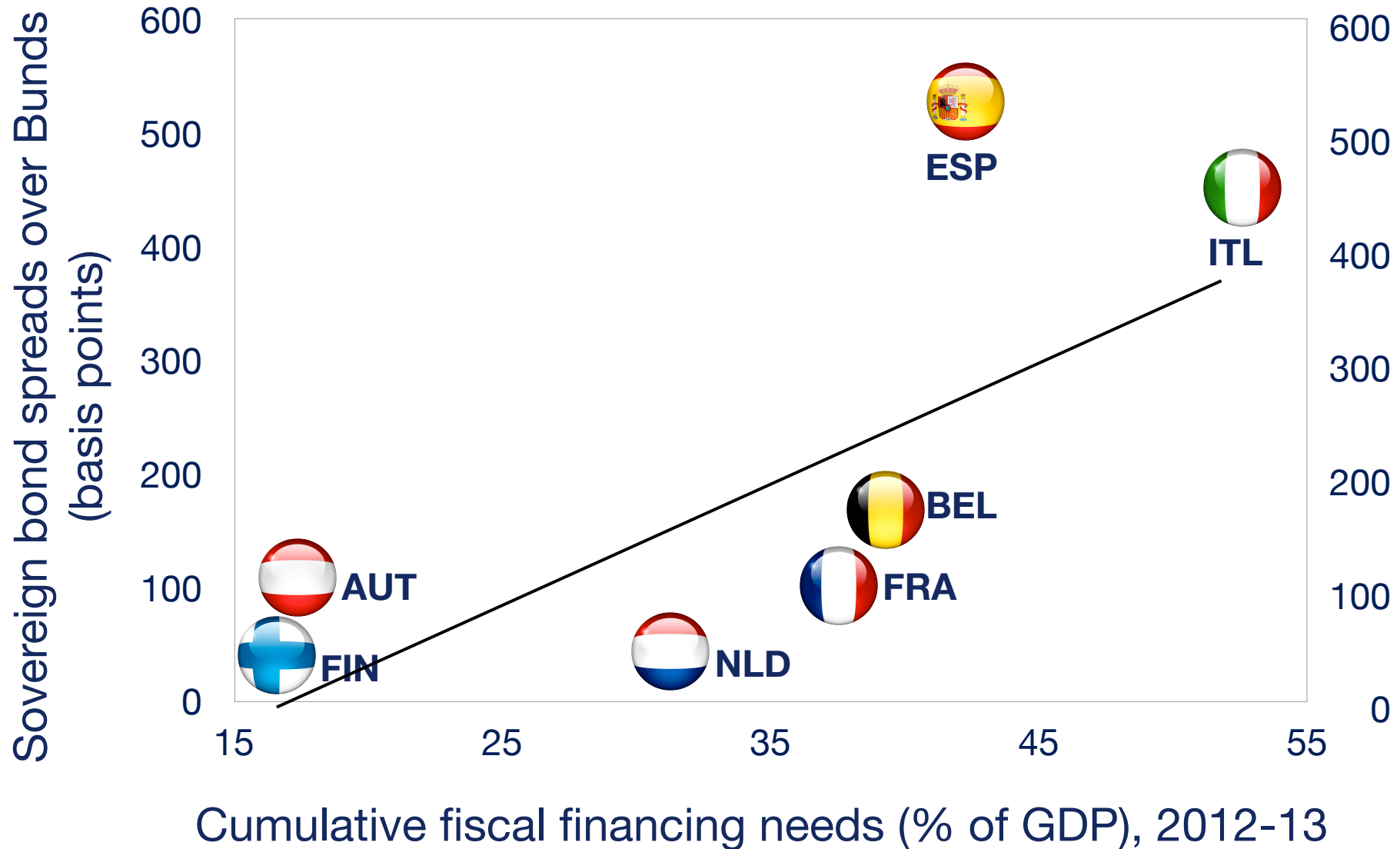
Euro Area Stresses

Stress Remains Elevated

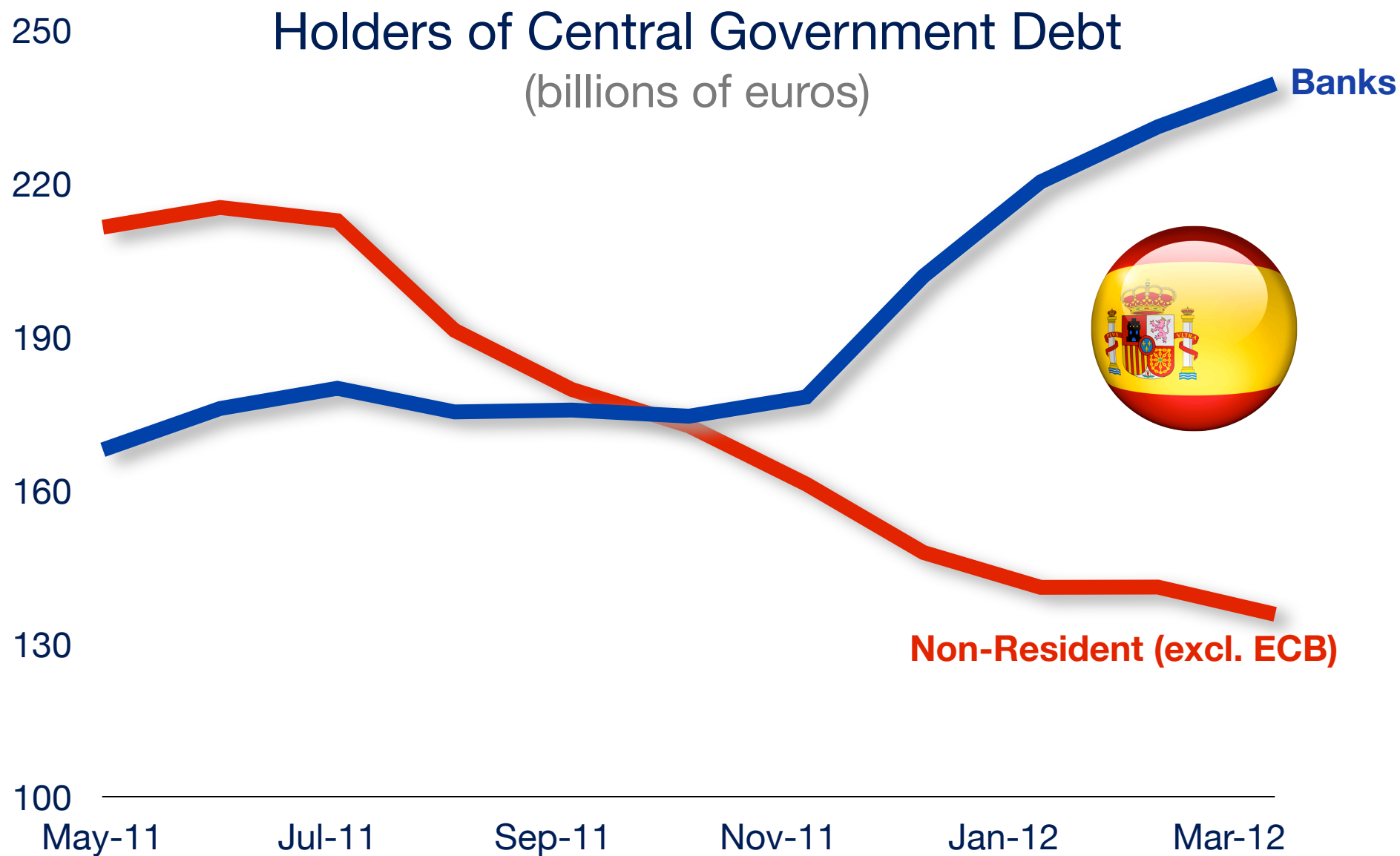
Credit Default Swap Spreads
(Basis points weighted by gross debt)



Financing Needs Increase Stress

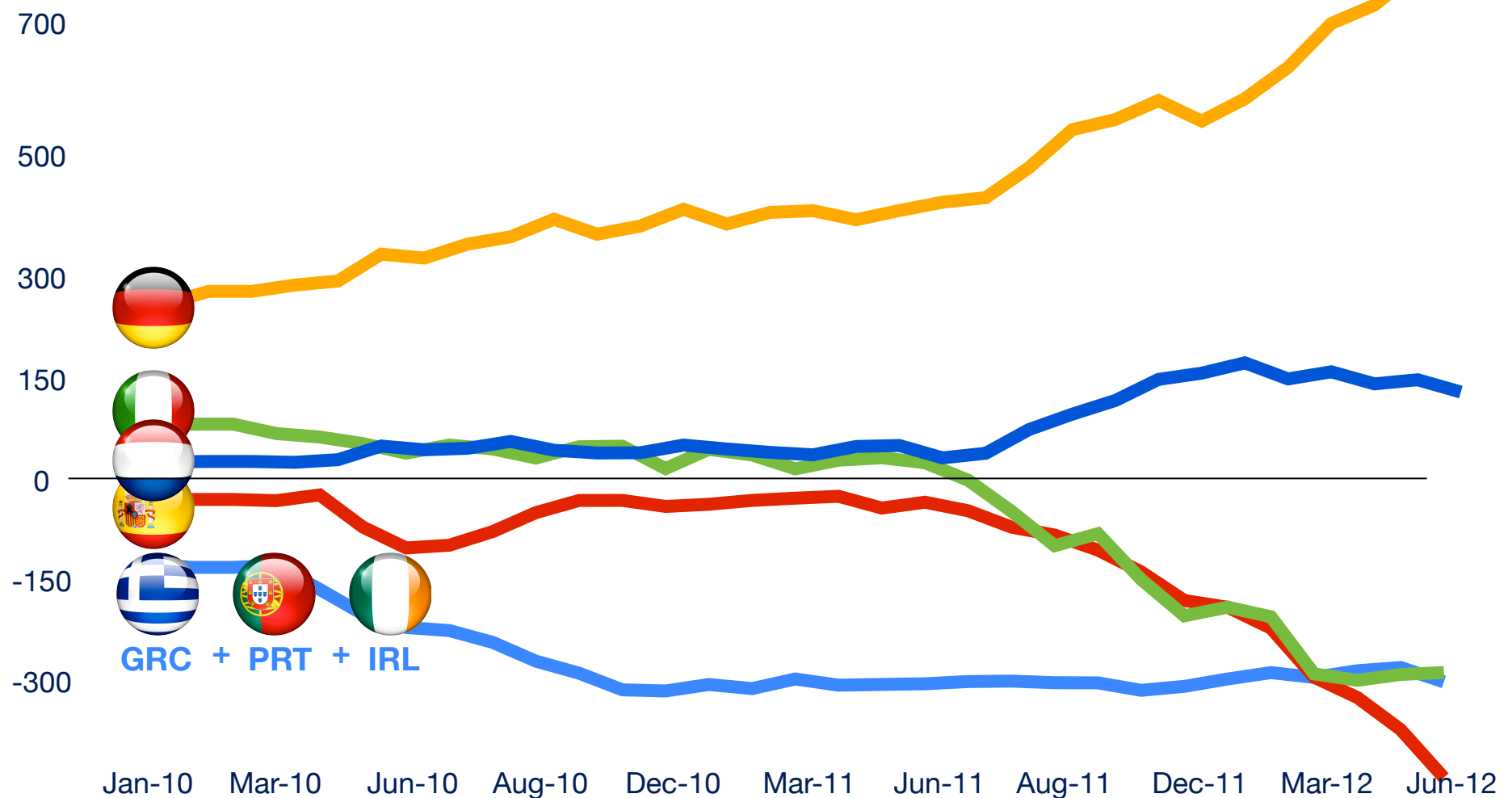


Sovereign Bank Links Intensify

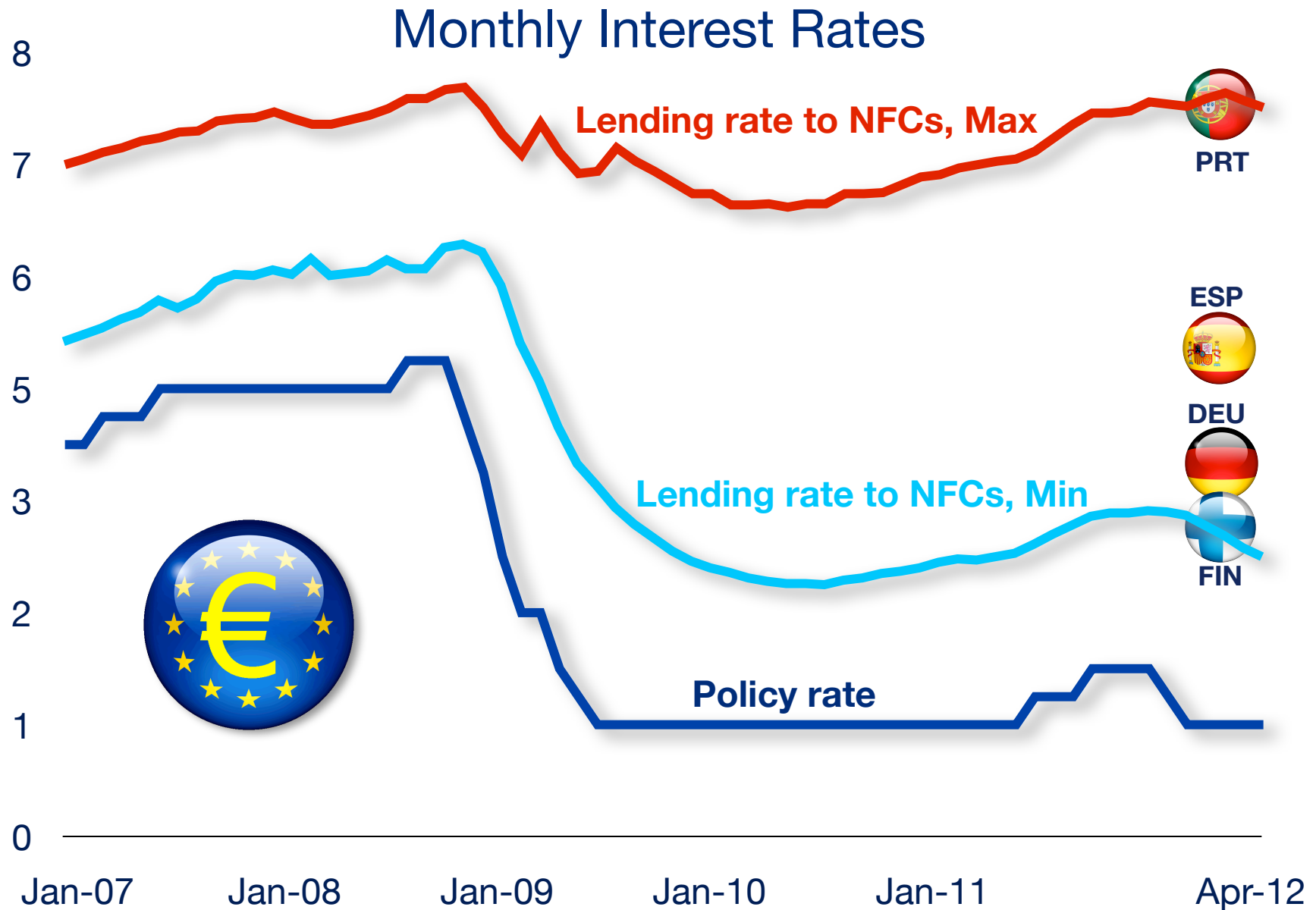


Public Replacing Private Funding

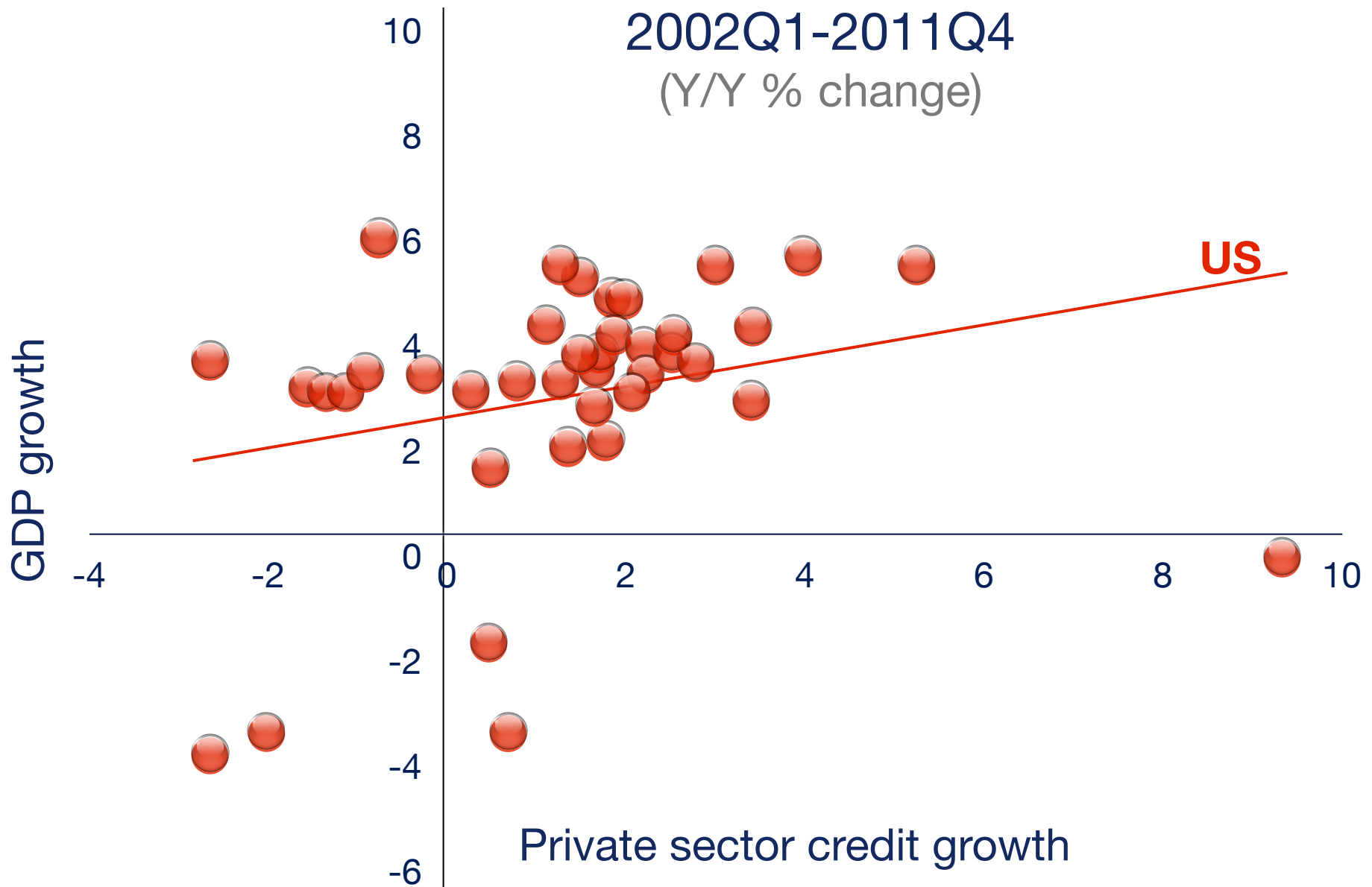
Net Balance with The Eurosystem (Target 2)



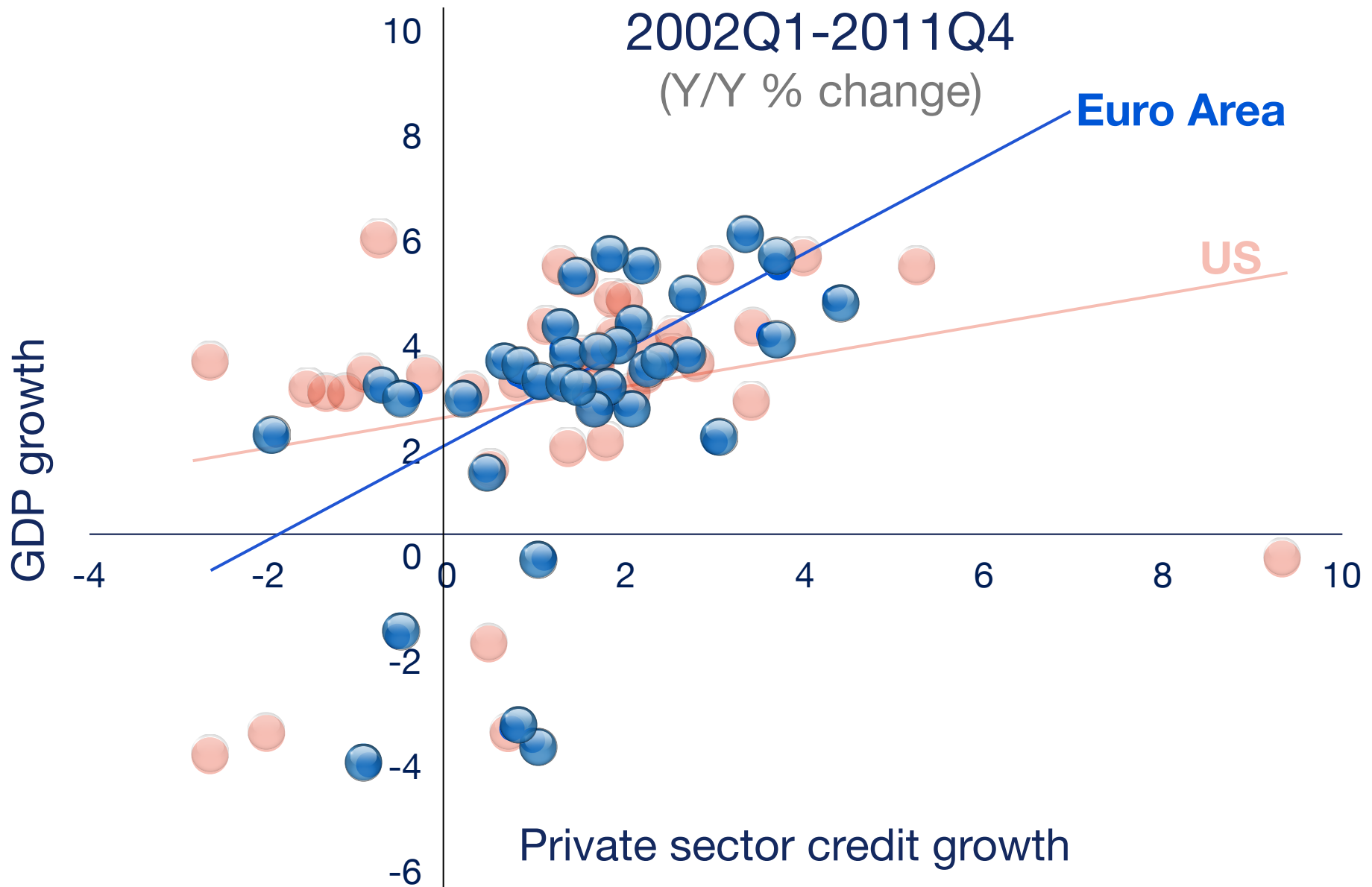
Diverging Lending Rates



Credit and GDP Growth



Credit and GDP Growth

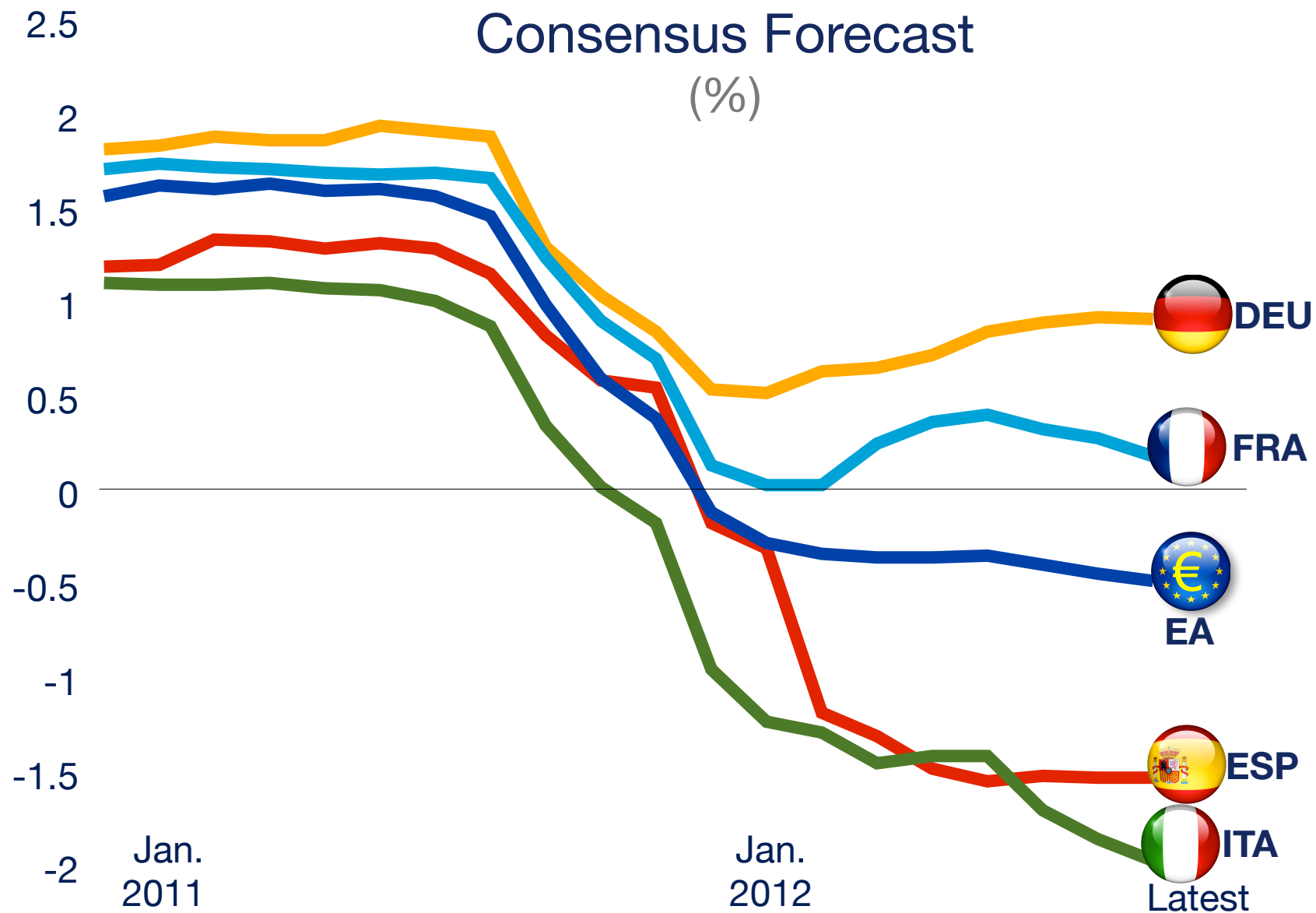




Euro Area Growth

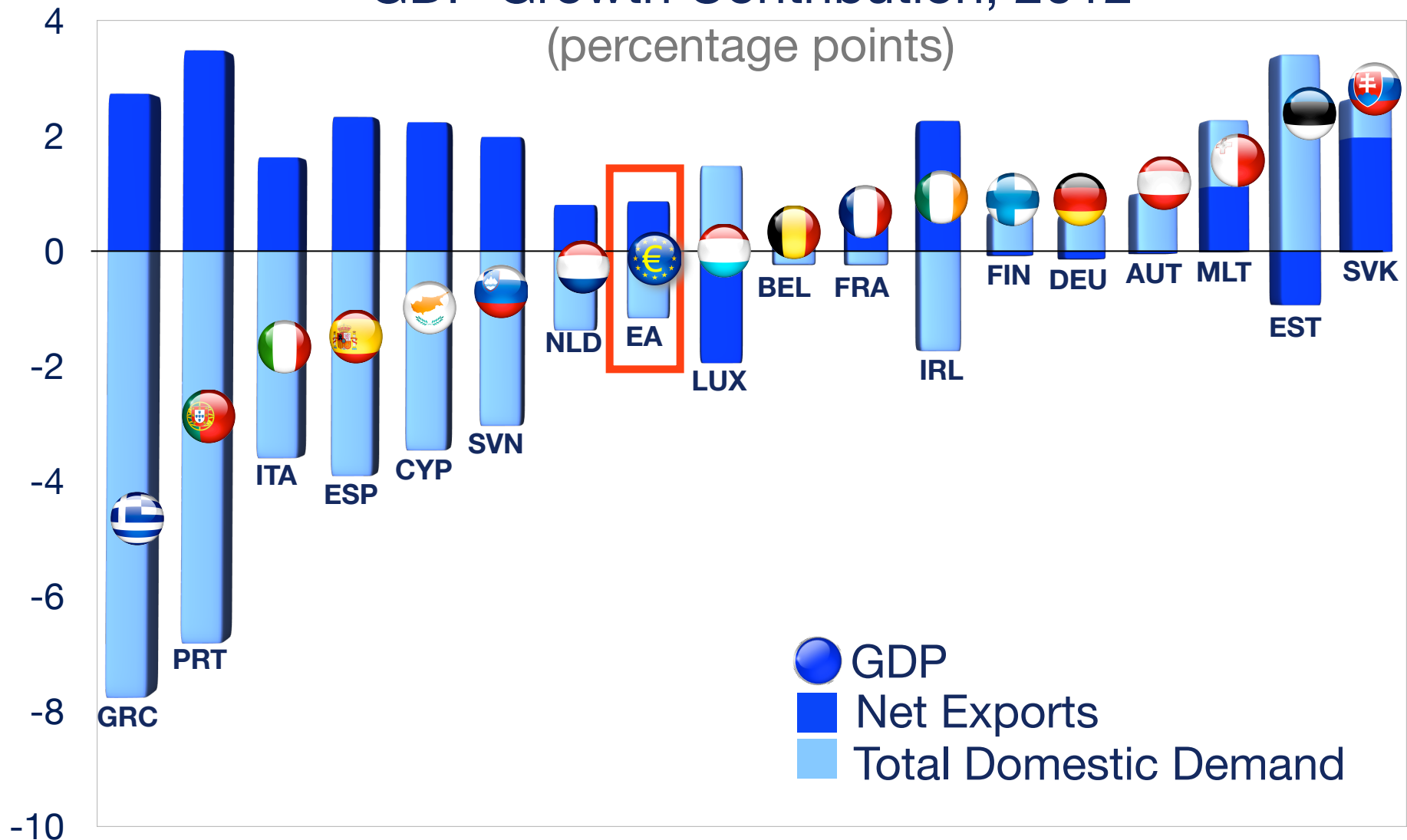
Outlook on Downward Path

GDP Growth for 2012: Consensus Forecast (%)



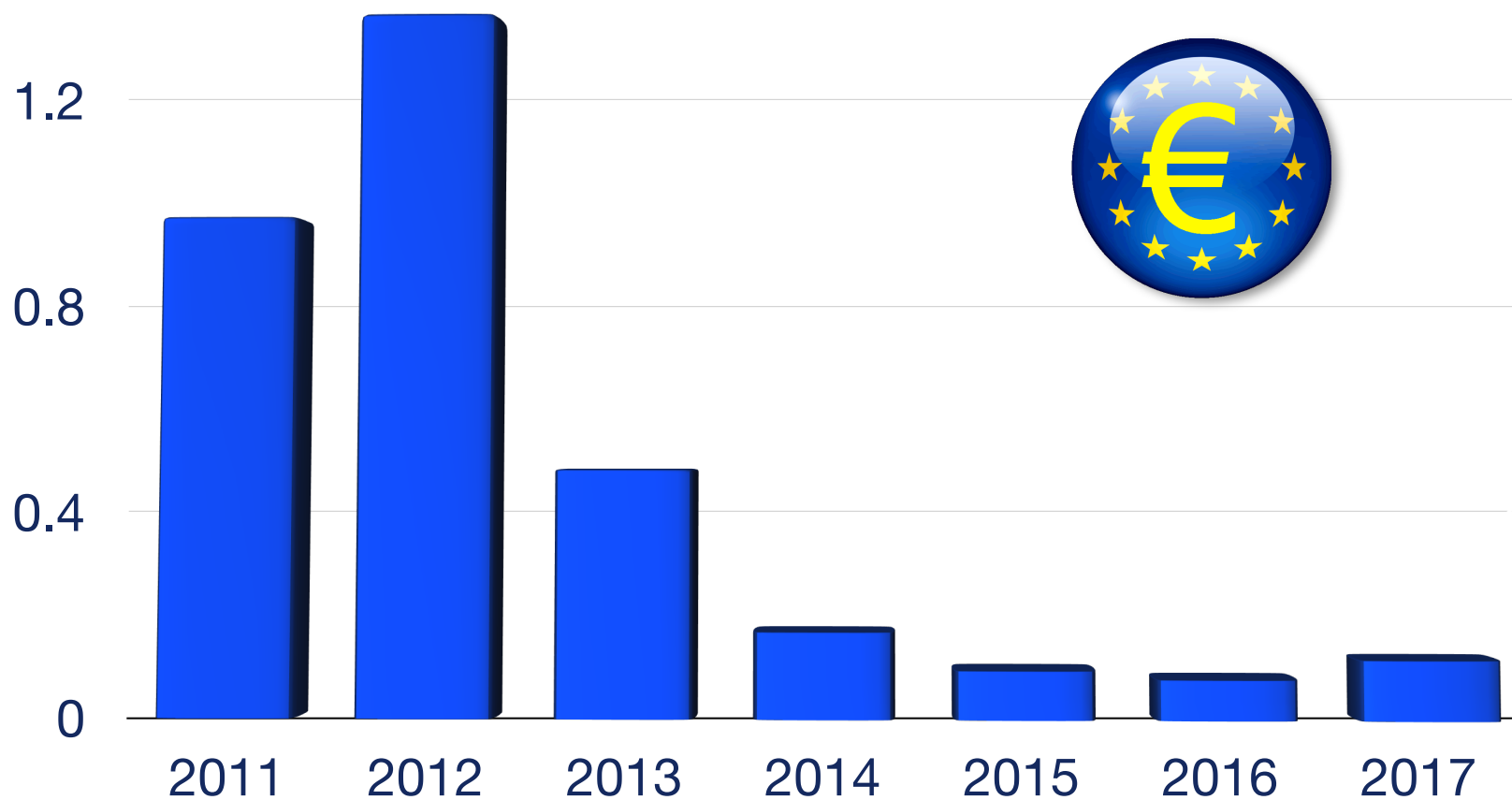
Domestic Demand Plunging in EA

GDP Growth Contribution, 2012
(percentage points)

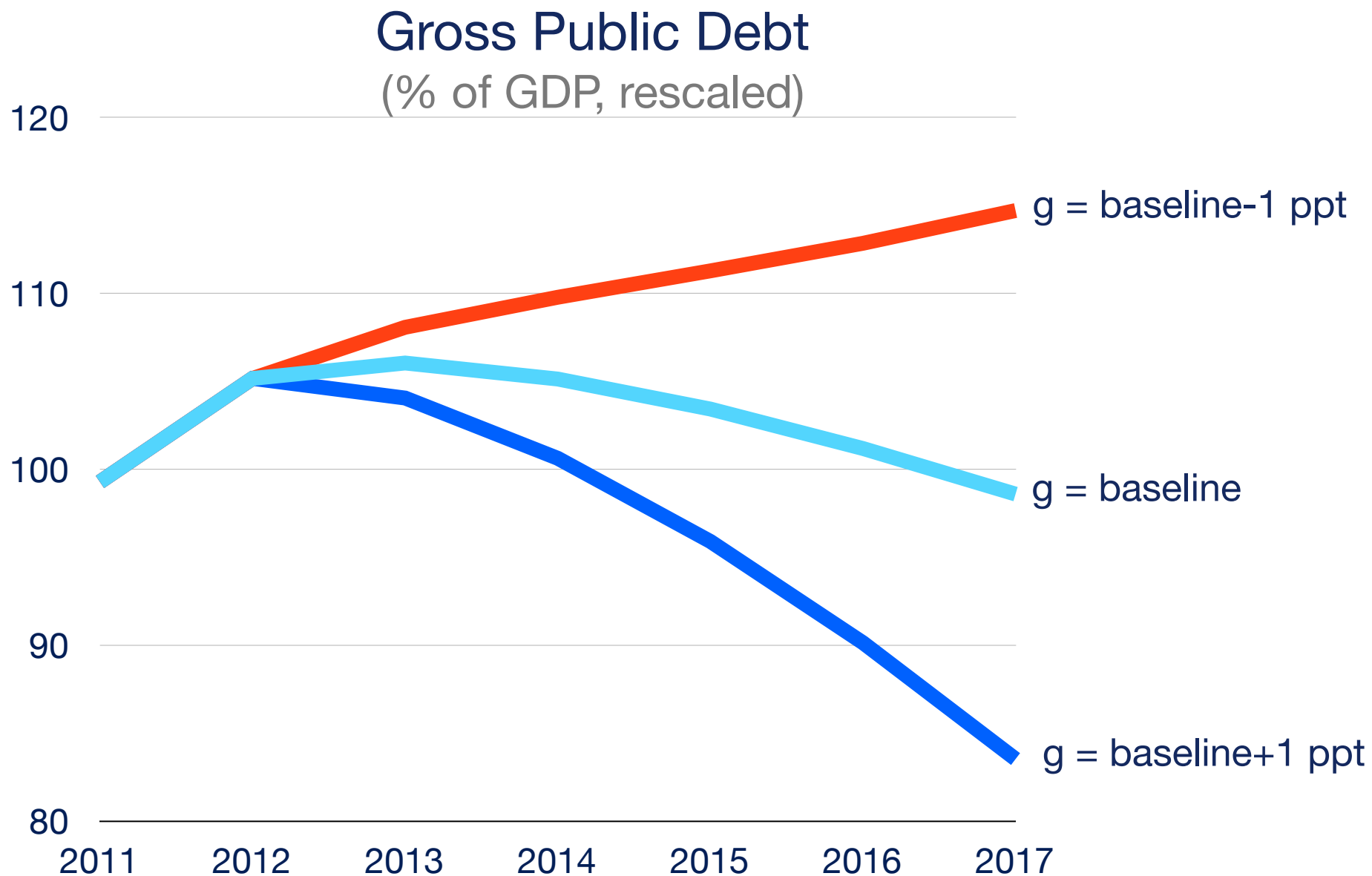


Front-Loaded Fiscal Effort

Annual Change in EA17 Structural Balance
(% of GDP)



Growth Impacts Debt

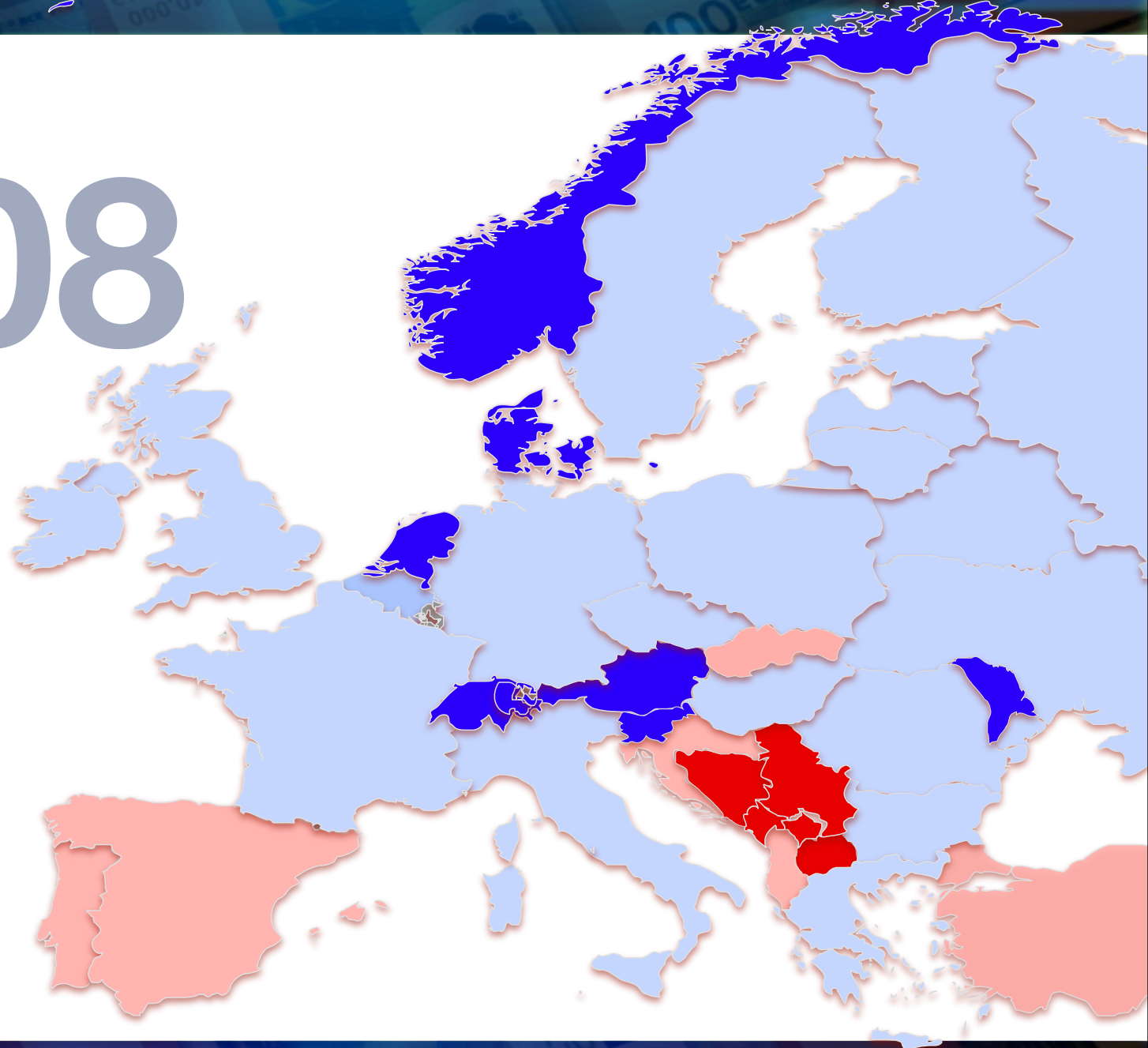


Unemployment Has Surged

2008

percent

0-4
4-8
8-12
12+

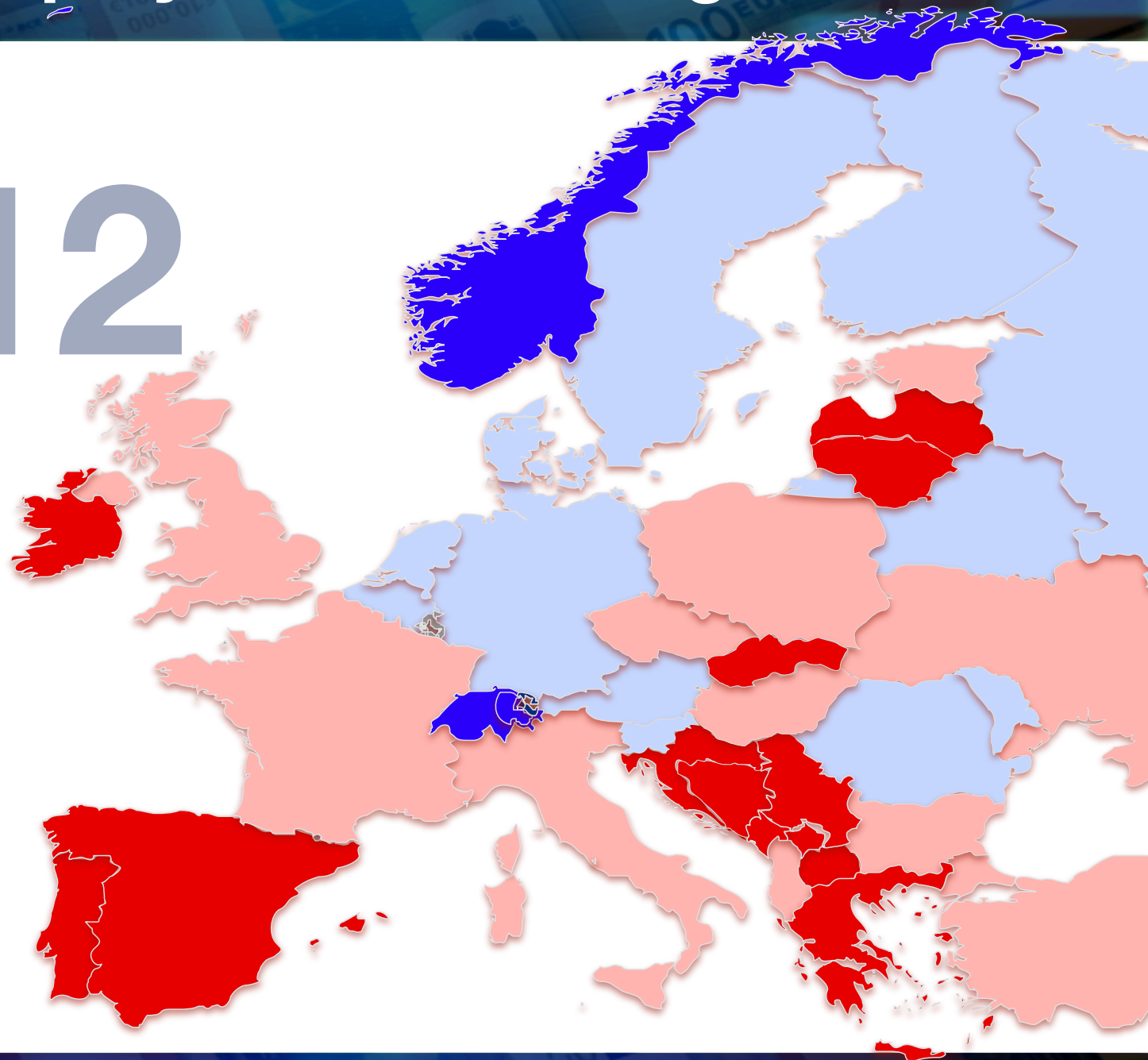


Unemployment Has Surged

2012

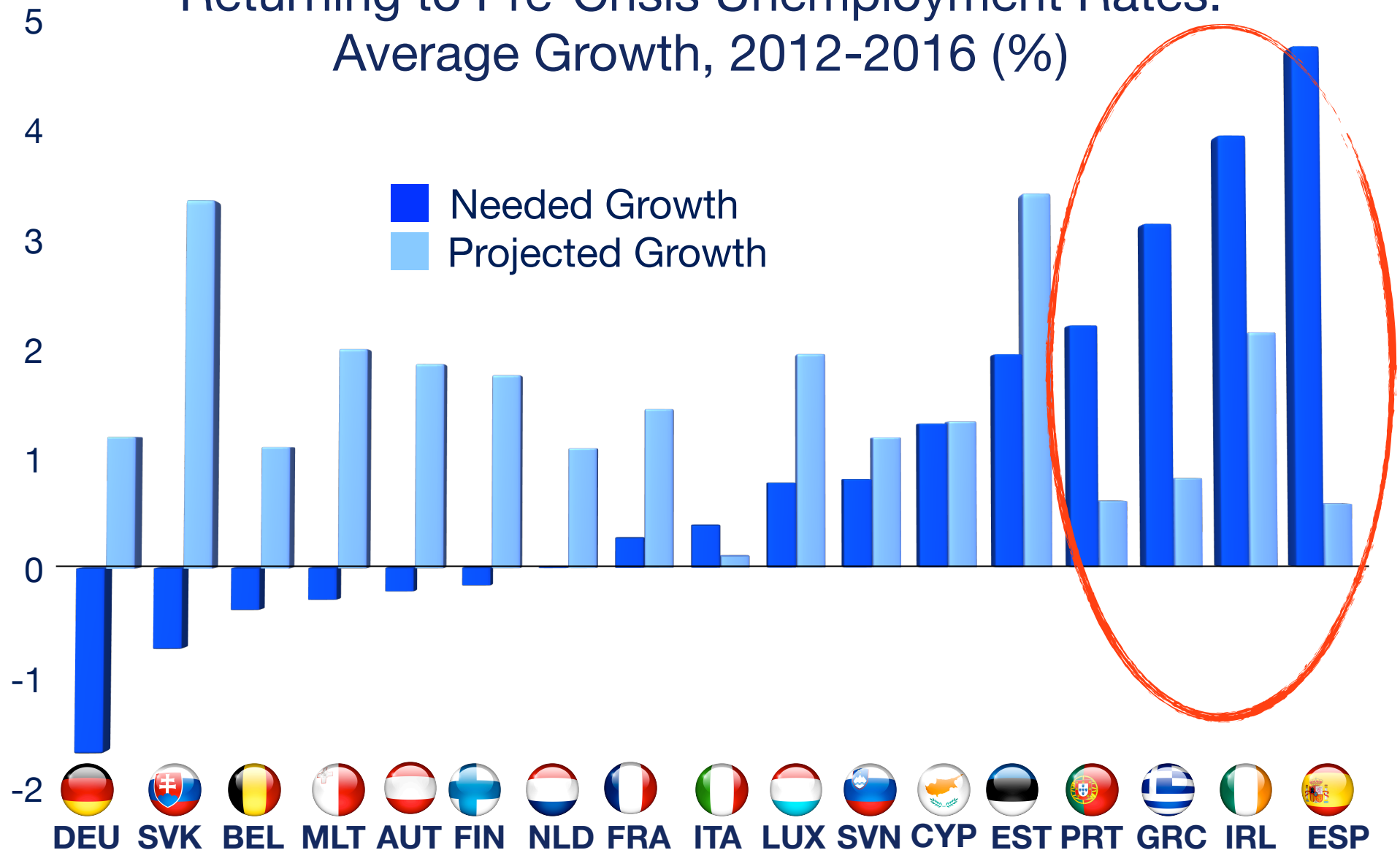
percent

0-4
4-8
8-12
12+



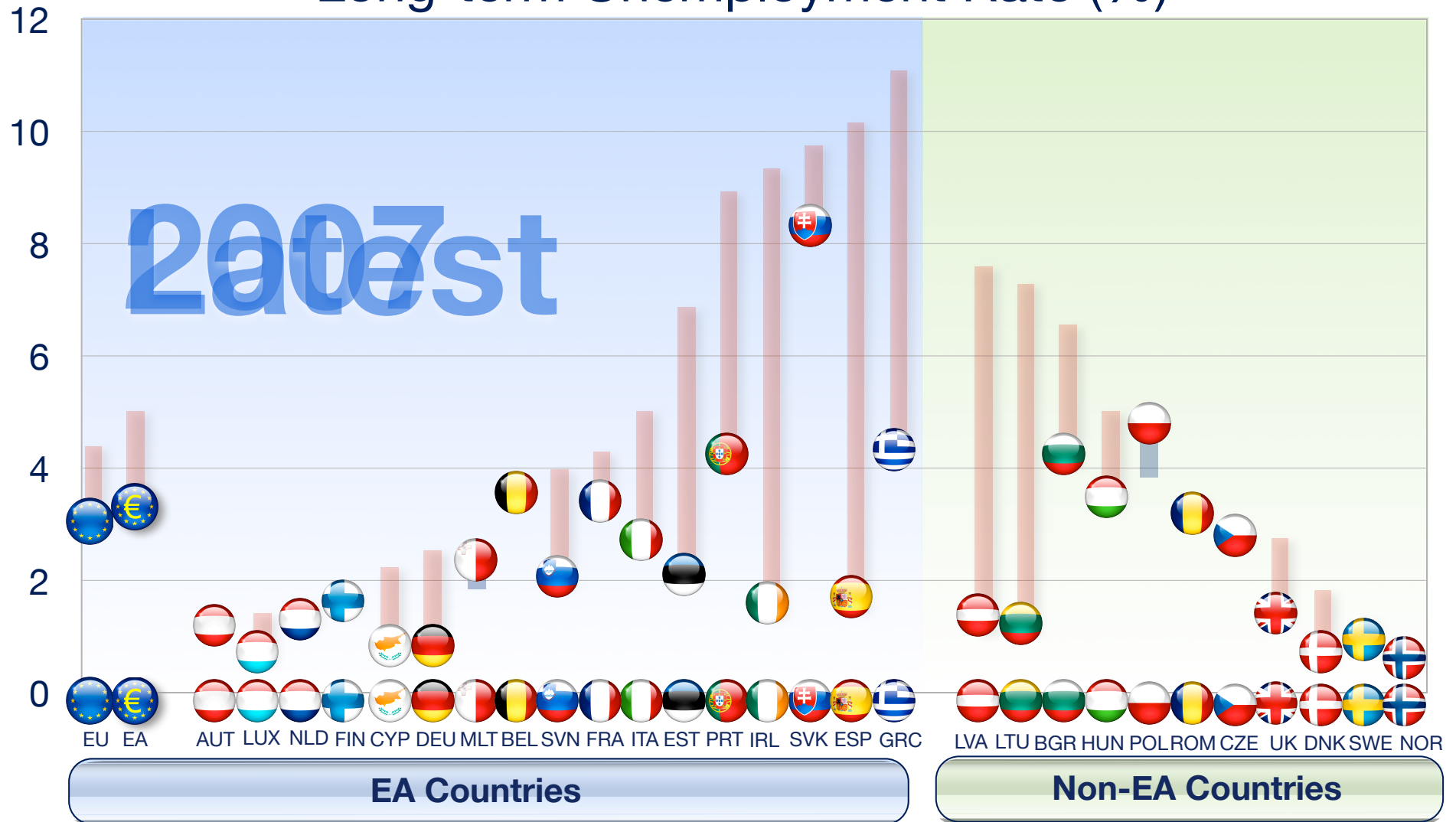
Reducing Unemployment Not Easy

Returning to Pre-Crisis Unemployment Rates:
Average Growth, 2012-2016 (%)



Potential Skills Loss

Long-term Unemployment Rate (%)





Euro Area Policies Architecture

Banking Union

**Common
Deposit Insurance**

**Common
Resolution**



**Common
Supervision**

**Single
Rulebook**

The Case for a Banking Union

- **Financial Stability national → Fragmentation**
- **Uncertainty about banks → Adverse growth effect**

Banking union

- Severs adverse feedback loop between banks and sovereign
- Provides incentive to end financial de-integration
- Helps restore monetary policy transmission

Elements of a Banking Union

- **Common deposit guarantee**

- ▶ Reduces dependence of banks on their sovereign
- ▶ Increases depositor confidence

- **Common bank resolution**

- ▶ Authority to bail in private sector creditors
- ▶ Facilitates orderly wind-down of failing institutions and deleveraging

- **Common supervision**

- ▶ Foster stability
- ▶ Deter fragmentation

Fiscal Union

**Fiscal Compact/
Governance**

**Euro Area
Bills/Bonds**



**Focus on
Structural Balance**

**Larger Central
Budget**

The Case for a Fiscal Union

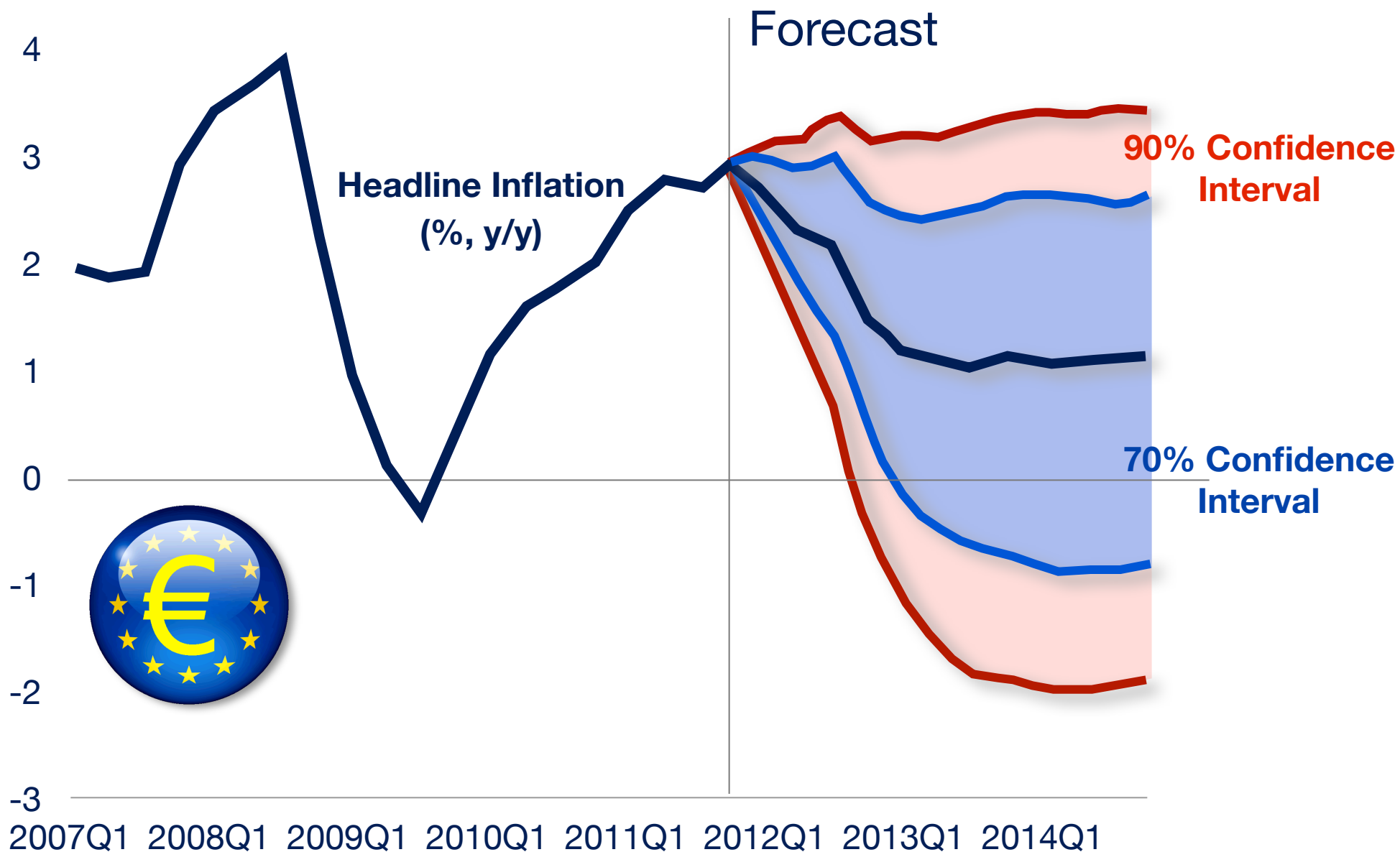
- **Enhance adjustment to idiosyncratic shocks**
- **Deal with externalities and prevent contagion**
- **Reduce need for costly *ex-post* bailouts**
 - ▶ ***Financial stability***: area-wide back stop
 - ▶ ***Transfer and tax scheme***: provide insurance against idiosyncratic shocks
 - ▶ ***Public goods***: centrally provided, but region's relative tax contribution falls in downturn
- **Need strong governance arrangements to address moral hazard**
 - ▶ Limit fiscal sovereignty
 - ▶ Ensure behavior in line with common standards

The slide features a decorative header and footer consisting of a blue-tinted image of Euro banknotes, specifically showing the '100 EURO' and '€10.000' text. The main content area is white and contains the following text:

Euro Area Policies

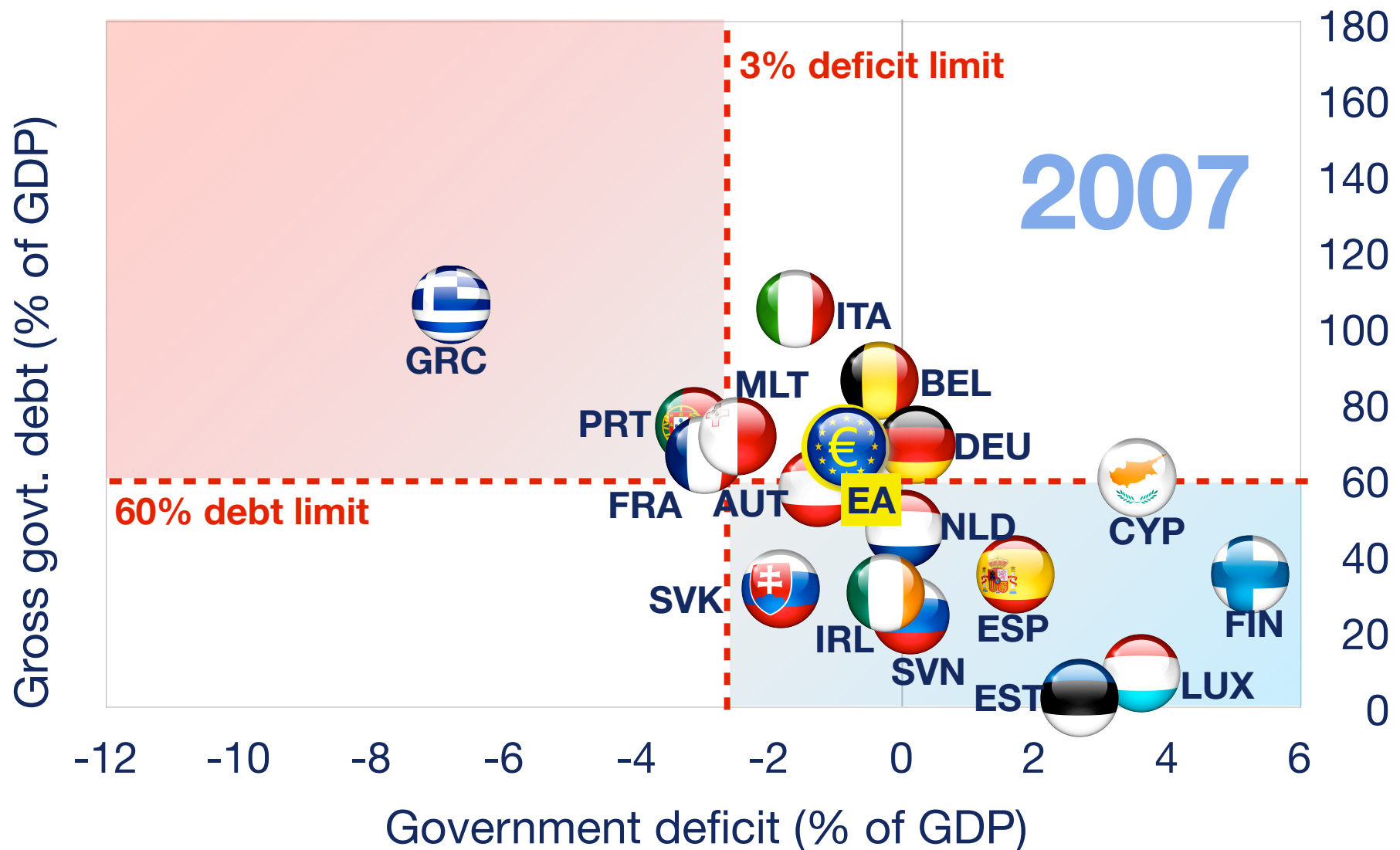
Short-run Demand

Inflation low and declining



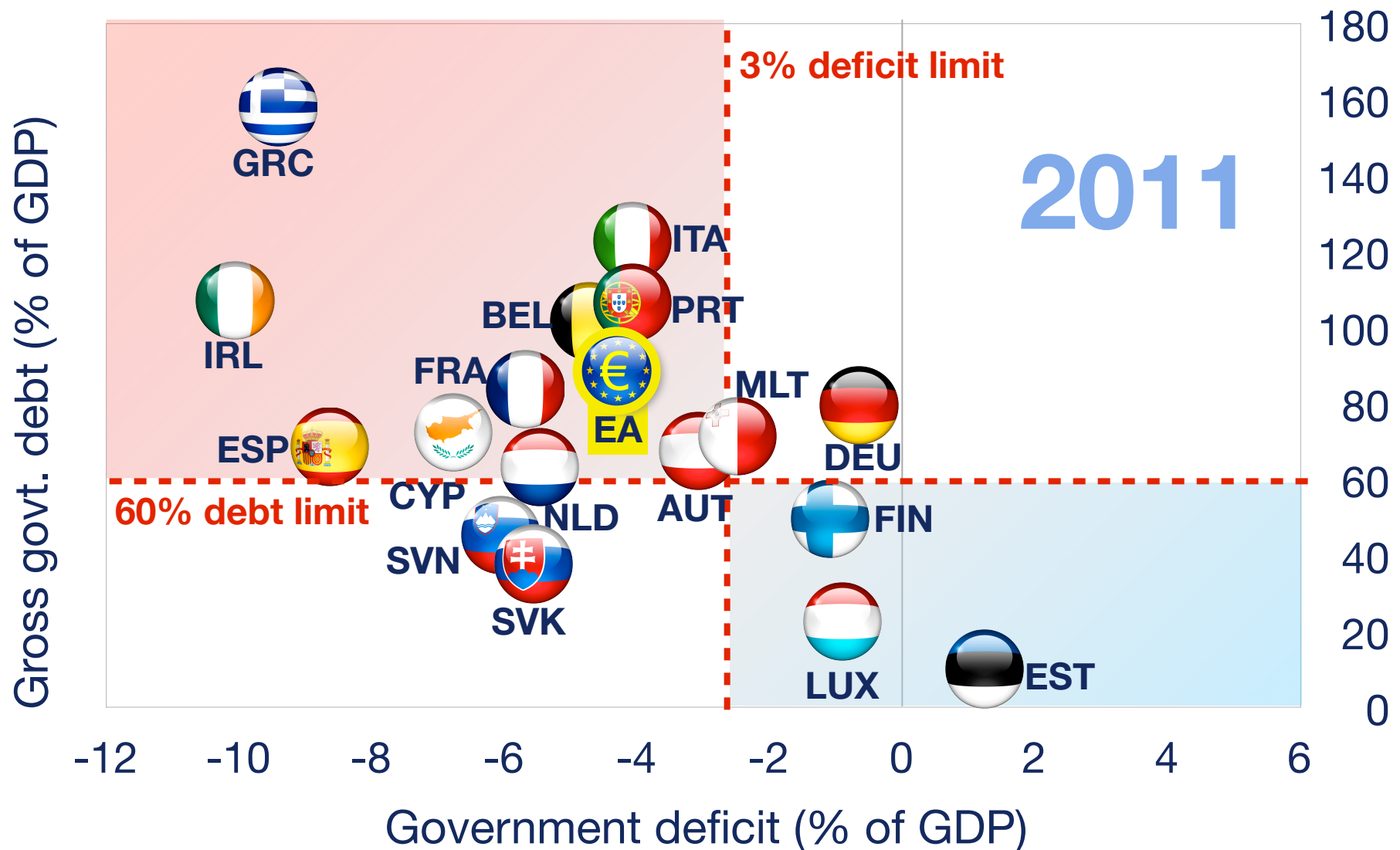
Maastricht Criteria

Compliance with SGP Rules

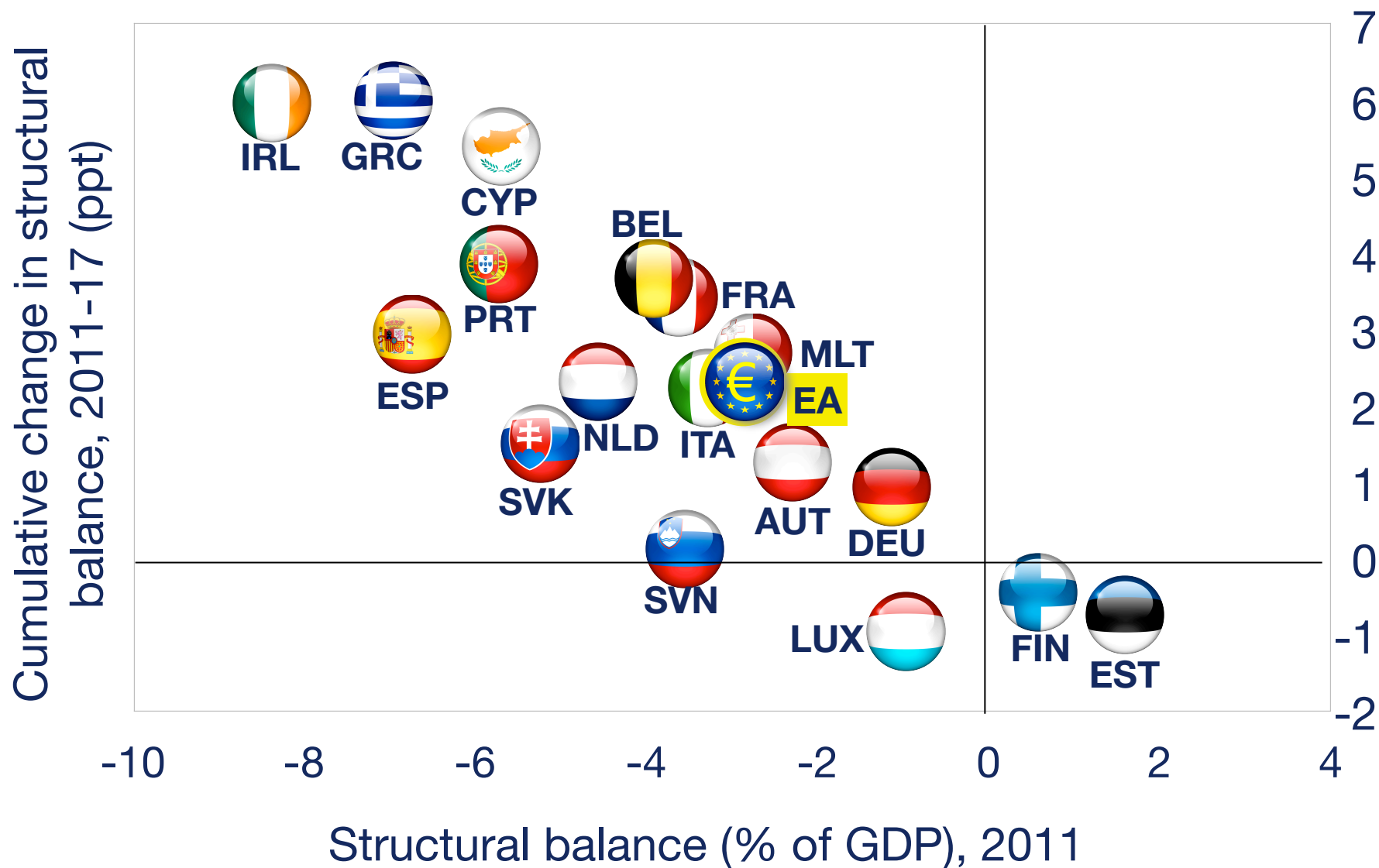


Maastricht Criteria

Compliance with SGP Rules



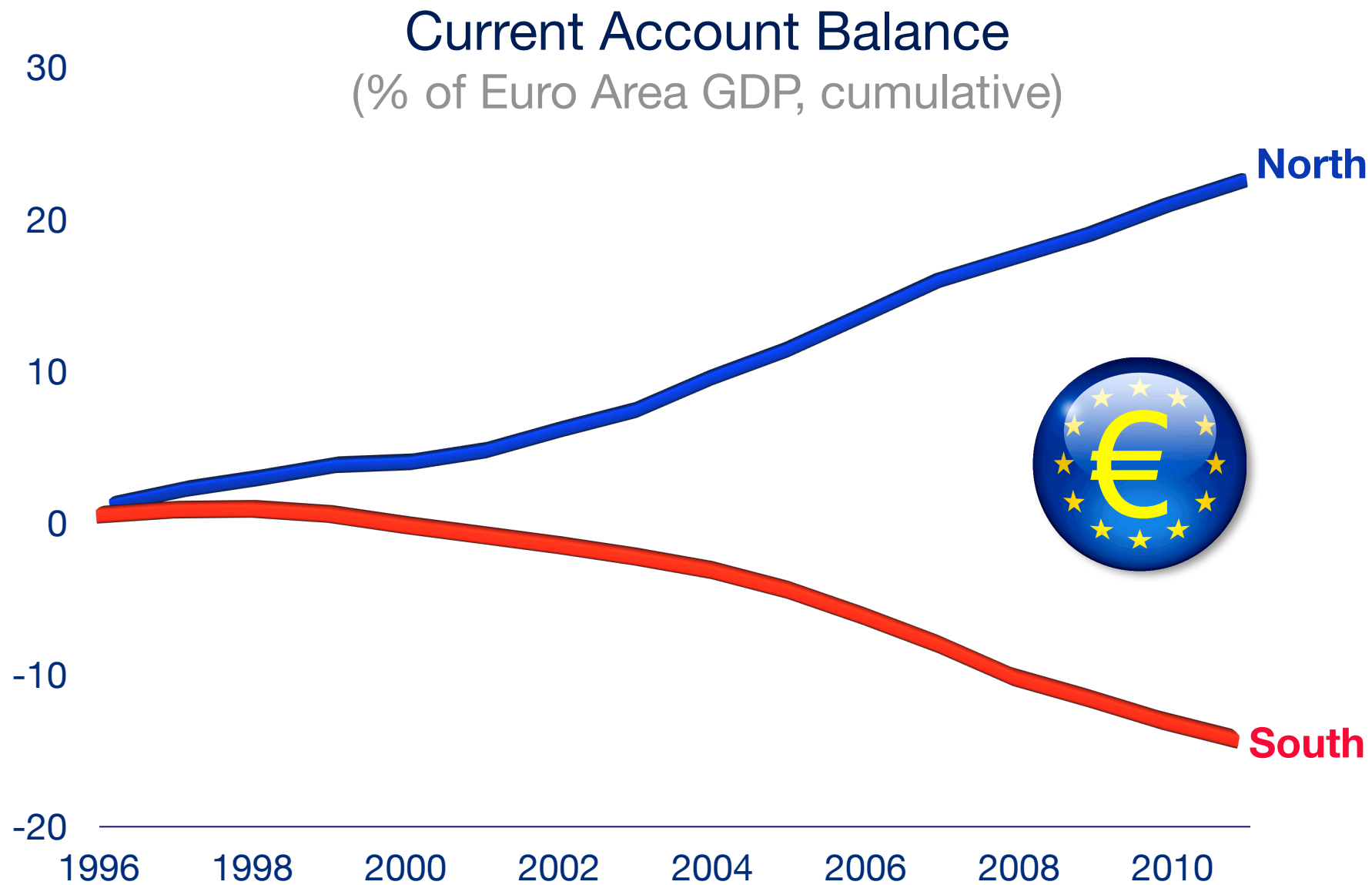
Ambitious Fiscal Effort



The image features a decorative header and footer with a blue and green color scheme, overlaid with a pattern of Euro banknotes. The banknotes are slightly blurred and tilted, creating a sense of depth. The text is centered in a bold, dark blue font.

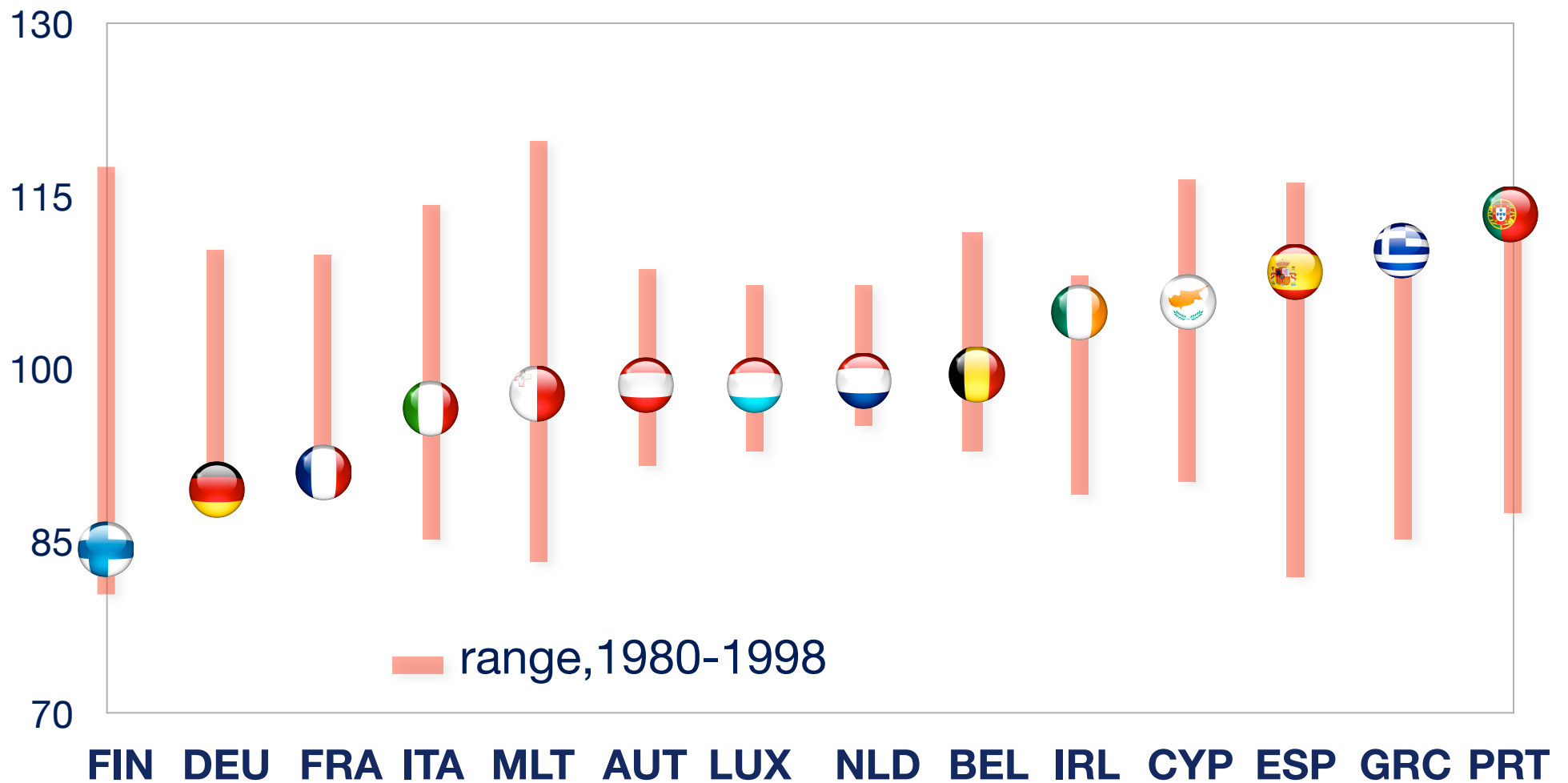
Euro Area Policies Structural

Current Accounts Diverged



South: Competitiveness Gap

Real Effective Exchange Rate Index (CPI based)
(average 1980-1998=100)



Conclusions

- **Financial markets remain under stress**
- **Growth prospects are deteriorating**
- **Roadmap towards complete EMU can arrest decline in confidence**
- **Macroeconomic policy support needed in ST**
- **Structural reforms needed to address external imbalances**

The image features a decorative border at the top and bottom, consisting of a dark blue background with a pattern of 100 Euro banknotes. The banknotes are slightly blurred and overlapping, creating a sense of depth. The text "Thank you" is centered in the white space between the borders.

Thank you